Whiteside & Associates

Memo

From: Terry Whiteside

To: **Montana Wheat and Barley Committee**

Date: May 16, 2008

Re: Transportation Report

STB HOLDS IMPORTANT HEARING ON COMMON CARRIER OBLIGATIONS OF RAILROADS ON APRIL 24TH

The STB in Ex parte 677 held a most interesting hearing in Washington DC two weeks ago that will have an impact on all shipping by rail in the coming years.

The hearing was another one that mirrored the tale of two cities.

The Shippers recounted scenario after scenario of instances where railroads were and continue to skirt their long standing common carrier obligation while the carriers postured that they were working well within the common carrier obligation.

Congress is hearing ever increasing complaints about railroads running rough shod over shippers (especially captive shippers). For background, The STB exercises limited oversight on the nations' railroads. It convened the hearing to discuss the common carrier obligation of railroads, the statutory duty to provide transportation or service on reasonable request (49 U.S.C. 11101). More than 40 witnesses appeared at the two-day hearing and others submitted written comments only.

Montana's Governor Schweitzer filed Joint Statements and testified together with the Montana Wheat & Barley Committee, Montana Farmers Union, and the Montana Grain Growers Association coupled with a large group of wheat and barley groups which included: Colorado Wheat Administrative Committee, Colorado Association of Wheat Growers, Idaho Barley Commission, Idaho Wheat

Whiteside & Associates, 3203 Third Avenue North, Suite 301, Billings, MT 59101, Phone: 406-245-5132 email: *twhitesd@wtp.net*

Commission, Idaho Grain Producers Board, Nebraska Wheat Board, Oklahoma Wheat Commission, South Dakota Wheat Commission, South Dakota Wheat Inc., Texas Wheat Producers Board, Texas Wheat Producers Association, Washington Wheat Commission, Washington Association of Wheat Growers and the Alliance for Rail Competition.

The Governor, et al stated in their filing, "Issues of rate regulation are relevant to the Railroads' common carrier obligation because, absent effective recourse for captive shippers, railroads will be free to avoid providing service through the simple but effective expedient of making the services they do not want to provide prohibitively expensive."

"Railroad calls for minimal or no regulation based on alleged capacity constraints that are not limited to rate issues. In Docket No. 42060 (Sub-No,. 1), North America Freight Car Association v. BNSF Railway Company, the Board addressed the complaint of providers of private covered hopper cars and other cars used for transportation of agricultural commodities, who were challenging the decision of BNSF to end its long-standing practice of providing storage for empty private cars awaiting loading."

"BNSF defended its decision to impose unprecedented charges for such storage unless shippers provide their own storage, or lease track from BNSF, or agree to contracts with substantial volume commitments, squarely on capacity grounds. See the BNSF Reply Statement filed September 16, 2005 at 40:"

"In this case, the NAFCA Complainants had no basis for assuming that BNSF or any other railroad might not change their demurrage or storage charge practices with respect to empty private cars. The law is clear that they cannot claim reliance on BNSF's or any other railroad's past practice to carry their burden of proving "unreasonable practice" or a car service violation. This is particularly so in light of the necessity for BNSF and other railroads to address the circumstance in recent years of capacity constraints on their systems. The Board has made it a priority to encourage railroads to adopt new capacity-enhancing initiatives to meet the unprecedented demand for freight rail services from almost every sector of the shipping public. Change is not only expected by the Board, but demanded".

"BNSF made these arguments despite the fact that (1) Class I railroads have forced shippers to acquire freight cars for most shipments of agricultural commodities (not just peak harvest volumes);[1] (2) poor rail service increases the need for rail cars; and (3) BNSF had the most aggressive storage charge

[1] Class I railroads provide only about one-third of the nation's covered hopper cars and no tank cars.

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program of any major railroad, and imposed its charges regardless of whether cars stored on its lines affected capacity or congestion."

As Steve Strege and the North Dakota Grain Dealers Association stated in their press release after the hearing, "Railroads must be obligated to serve. They should not be able to pick and choose for only their own bottom line interests. They owe their customers and the public more than that."

The North Dakota Grain Dealers Association said when railroads are granted larger service territories through mergers approved by a public body, such as the Interstate Commerce Commission or the STB, some obligations to the public come with it. Providing essential service is one of those. The Association pointed to North Dakota's diversity of crops, many sold in lots of one car or several instead of 100-car trains. "These should not be pushed to the back of the line in preference for only larger shipments. The common carrier obligation applies to all of them and most big shippers also use small shipment sizes too," the Association said.

The ND Grain Dealers said that since railroad deregulation in 1980 the rail industry has consolidated into fewer larger railroads and the balance of power has shifted even more in their favor. Therefore the STB must take a stronger hand in protecting the interests of rail customers. Problem areas cited include excessive exploitation of captive shippers through extreme rates, including inverse rates, and fuel surcharges that exceed actual increased cost of fuel.

IS THE RAIL CAPACITY SHORTAGE A STUDIED REALITY OR DOES IT CONTAIN SOME HYPE?

One of the main thrusts by Governor Schweitzer's and the united farm groups statement is whether the claims of a rail capacity shortage are being hyped by the nation's railroads to attain regulatory favor or Congressional monies.

"Unfortunately, it appears that the railroads' claims of capacity constraints, and their calls for light-handed or ineffective regulation, have been accepted too uncritically. With so many issues of such importance hanging in the balance – not just the future of the common carrier obligation, but also fundamental issues of rate and service regulation, and fundamental issues of how much say railroads should have in how captive shippers operate – it is incumbent on the Board to test the Railroads' capacity and congestion claims before handing the Railroads the keys to the kingdom."

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“In this connection, the Board should take official notice of the recent Final Report of the National Surface Transportation Policy and Revenue Study Commission. That Commission was established by Congress in the 2005 Highway Bill, SAFETEA-LU, and charged with assessing national infrastructure needs and options for meeting increased demand, including increased demand for freight transportation.”

“The Commission’s Final Report amply supports the proposition that additional infrastructure funding is needed. However, when the Commission analyzed the railroad industry, its findings hardly supported a free hand for Railroads with respect to raising prices or rejecting service requests. On the contrary, the Commission found, based on AAR data, as follows:

> By contrast, the Nation’s freight rail network is relatively uncongested at current volumes of cargo (see Exhibit 3-8). Eighty eight percent of today’s primary freight rail corridor mileage is operating below practical capacity (Levels of Service (LOS) A/B/C). About 12 percent is near or at practical capacity (LOS D/E), and less than 1 percent is operating above capacity (LOS F).

Final Report at page 3-15.

“Moreover, the Commission’s findings appear to have been taken from the Cambridge Systematic report commissioned by the AAR, and those findings <u>predate</u> the current economic slump, which has led to <u>overcapacity</u> for railroads and other carriers. <u>Transport Topics</u> recently reported that BNSF has idled some 5% of its car fleet, parking upward of 1000 cars in Montana alone, due to the current “freight recession.” Notably, BNSF CEO Matt Rose was a member of the 9-1 majority voting in favor of the Final Report of the National Surface Transportation Policy and Revenue Study Commission.”

“The AAR has argued, and the Commission found, that rail capacity constraints may exist in the future. See Final Report at 4-14, where the Commission concluded that, by 2035, 54% of freight rail corridor mileage will be below or near capacity, 15% will be at capacity, and 30% will be above capacity. It is important to note, however, that these figures <u>assume no new capacity is added in the next 28 years</u>.”

All the while, “as the Railroads frequently point out, they have a commendable record of capital investment. The Final Report finds that an average total investment of $5.3 billion per year “is expected to be adequate to accommodate projected freight rail demand in 2035 to a point at which 98

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percent of primary rail corridors operate at a level below their theoretical capacity." Id. At page 4-14."

"To be sure, there are well-known instances of railroads failing to meet service demands from grain shippers, coal shippers, and other shippers. However, in view of the findings of the Final Report of the National Surface Transportation Policy and Revenue Study Commission, the Board should not be too quick to accept Railroad claims of urgent capacity and congestion problems warranting wholesale rationing of service or unimpeded pricing freedom (which amounts to the power to ration service as the Railroads wish)."

"Governor Schweitzer and these Agricultural Interests are aware that the Board concluded, in the January 14, 2008 Decision in Ex Parte No. 665, Rail Transportation of Grain, that grain shipper service and rate concerns warrant attention. See also the separate Comment of Board Member Buttrey. We are also aware of the Board's decision to commission a study of rail competition and capacity issues by Christensen Associates, partly as a result of Ex Parte No. 665 and partly as a result of GAO studies raising similar concerns."

"Under the circumstances, the Board must not assume too readily that excision of any part of the common carrier obligation is needed or desirable."

FARM BILL CONFERENCE REPORT – CONTAINS MANDATE OF USDA STUDY OF HOW RAIL TRANSPORTATION AFFECTS THE MOVEMENT OF AGRICULTURAL PRODUCTS – ANOTHER VICTORY FOR CAPTIVE AGRICULTURAL SHIPPERS

NOTE: The Alliance For Rail Competition working with agriculture was a moving force in attaining this part of the legislation and keeping it alive as the railroads fought against the provisions with everything they had.

Earlier today (May 15th), the Senate approved the farm bill conference report by an overwhelming margin (81-15). Yesterday, the House of Representatives did the same by an equally impressive margin (318-106).

The bill contains a very important provision mandating USDA to conduct a study in partnership with DOT of how transportation, and specifically rail, affects the movement of agriculture products. The provision includes multiple important areas that must be covered by the study that will have to be submitted to Congress within one year of the enactment of the Bill.

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The provision was originally included in the House version of the Farm Bill and sponsored by Congressman Tim Walz (D-MN), who has been a champion for shipper issues. ARC members worked tirelessly beginning last year to make sure this provision was included in the bill, despite the strong opposition from the railroads. After their defeat in the House, the railroads put significant pressure on the Senate and had a similar provision removed from the Senate version at the last minute. The railroads continued to oppose the provision until the final days of conference report negotiations, aided in their effort by the White House. ARC members effectively lobbied for the provision during the duration of the farm bill conference and led a diverse coalition of agriculture groups whose support was key to this legislative victory. Despite the railroads' strong opposition and lobbying, the provision was included in the final version of the bill. Special thanks also goes to Sen. Amy Klobuchar (D-MN) who spearheaded the effort in the Senate.

In addition to lobbying for this specific provision, ARC joined multiple agriculture groups in a strong call to Congress to pass the conference report in defiance of the President Bush's veto threat. ARC showed strong support for its agriculture members by signing on to a letter calling for passage of the legislation with over 500 other organizations.

ED Note: This is how effective the captive rail effort has become. Despite a full court press by the railroads to kill this provision, the captive rail customers working together were able to achieve success.

The Bill should be sent to the White House early next week. He has stated earlier that he will veto the bill. If he does, the House and Senate plan to vote on the veto override prior to the Memorial Day recess which will begin May 26th.

EDITORIAL:

Railroads continue to push against all legislation in this Congress that would shine any light on their marketing, operational, or customer practices. They have opposed their industry opening up to anti-trust oversight like every other industry in America except baseball. They have opposed the STB revising the calculation of cost of capital in line with all other regulatory agencies, they have opposed STB efforts and Congressional urging to develop more simplified rate challenge process so small shipments can have access to review of small rate cases. The railroads have opposed the STB from considering rules that might open up the carrier system so smaller carriers (shortlines) might be able to provide competitive service for their customers. In summary the railroads have continued to publicly state they are working to solve railroad shipper issues but at the STB bar and in the halls Congress we see a completely different railroad industry.

The latest – with the revision of the calculation of the cost of capital – virtually all of the railroads will now be found to be revenue adequate – why is that important? Because a revenue adequate railroad's high or excessive freight rates cannot hide behind "revenue

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inadequacy" as a defense. So....the railroads are now attempting to change the basis of how their assets are valued – namely move from traditional (every other industry in America) book value to a 'replacement value'. Here we go again – talk out of both sides of their mouth – on the one hand they do want government intervention to protect their 'revenue adequacy' base, but on the other hand they do not anyone or anything to interfere with their monopoly power.

As Don Fast, of the Montana Wheat & Barley Committee, stated "every time the railroads claim they are increasing efficiency and they state that will be good for us, it usually translates to mean that we, as farm producers, will have to pay more due to increased costs forced onto the producer."